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BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN
COMMISSIONER-CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE COMPETITION IN)
THE PROVISION OF ELECTRIC SERVICES)
THROUGHOUT THE STATE OF ARIZONA)

DOCKET NO. U-0000-94-165

NOTICE OF FILING

Enrique Lopezlira hereby provides notice of filing of his rebuttal testimony as required by the Commission's Fifth Amended Procedural Order, dated the 29th day of January, 1998, in the above-referenced docket.

RESPECTFULLY SUBMITTED this 4th day of February, 1998.

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By:

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Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE COMPETITION IN)	DOCKET NO. U-0000-94-165
THE PROVISION OF ELECTRIC SERVICES)	
THROUGHOUT THE STATE OF ARIZONA)	COMPREHENSIVE SUMMARY OF
)	ATTORNEY GENERAL'S PREFILED
)	TESTIMONY AND REBUTTAL TESTIMONY

The Electric Competition Rules **should be modified** regarding stranded costs in a number of instances to:

- **Identify the markets** to which stranded cost analysis can apply
- **Apply a free-market philosophy** wherever possible
- **Better define stranded costs** for efficient calculation and to
- **Eliminate unnecessary regulation** and administrative proceedings
- **Eliminate CC&N market limitations**

Affected Utilities” **should not be required to make a “stranded cost” filing** pursuant to A.A.C. R14-2-1607 because:

- The **market-determined number** will be quicker and more accurate
- Only the market can identify **those assets that will gain value** under competition

Stranded costs should be **calculated quickly after the rules become certain** because:

- Market certainty will generate **rapid competition to benefit users**
- **Less burden on taxpayers and ratepayers** of continued regulatory proceedings

1 Stranded costs should be calculated in every case using a **market-value approach**
2 because:

- 3 • The market is more likely to result in **zero stranded costs**
- 4 • The market price is the **true measure** of what has, in fact, become uneconomic
- 5 • Stranded costs will be calculated **quicker and more accurately**

6
7 For investor-owned utilities this calculation should be done using a **split-stock market**
8 **value** approach, and for non-investor owned utilities and cooperatives, stranded costs
9 should be evaluated on an **asset-divestiture (or bid-auction) basis** because:

- 10 • It is the **fastest and most accurate** way
- 11 • It will **not undervalue assets**
- 12 • Value will be established by those with a **financial stake in the outcome**
- 13 • **Investors are protected** from future uncertainty
- 14 • **Ratepayers and taxpayers are protected** from future uncertainty and error
- 15 • **Faster competition** will occur

16
17 The **administrative calculation method proposed is not the best choice** because:

- 18 • It will take **too long**
- 19 • It is **continued regulation**
- 20 • It is too costly putting **unnecessary burdens on taxpayers and ratepayers**
- 21 • It **promotes inefficiency**
- 22 • It continues **market uncertainty**

23
24 **Net Loss Revenue is a poor choice** of calculation methodologies because:

- 25 • It fails to account for **management error**
- 26 • It is **too uncertain**
- 27 • It is bound to contain **errors**
- 28 • It will **undervalue some assets**

1 • It is more likely to **overestimate stranded costs**

2 • It requires **costly administrative true-ups**

3

4 The only relevant time frame for calculating market values is at the **time the rules become**
5 **certain.**

6

7 Stranded costs should be **paid over no more than five (5) years** because:

8

9 • A longer period creates additional **market uncertainty**

10

11 **All historic users should pay** pro-rata for stranded costs because:

12

13 • Historic users received any **benefit of regulation**

14 • **Larger users should pay more** than smaller users

15 • Burdening new competition with stranded costs is a **barrier to competition**

16 • **Competitive retail rates should offset any increase** due to stranded costs

17

18 Stranded costs should be **collected from all users** through a fixed, non-bypassable
19 **monthly charge** because:

20

21 • Wires, access and exit charges are an **unnecessary impediment to competition**

22 • A monthly charge is **fairer and more efficient**

23 • a stranded cost recovery fund is **simple** to administer

24 • True-up proceedings are **unnecessary and too costly**

25

26 There should be **no price caps or rate freeze** imposed as part of the development of a
27 stranded cost recovery program because:

28

- 1 • Rate caps **deny the benefit of lower competitive rates**
- 2 • Rate caps are completely **regulatory**
- 3 • Rate caps **allow inefficiencies** to continue
- 4 • Rate caps will become a floor for **future rate cap increase petitions**

5

6 The only factor that should be considered for “mitigation” of stranded costs is:

7

- 8 • **less than 100%** recovery to reflect **investor risk**
- 9 • less than 100% recovery to **induce efficiencies** in the phase-in period

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REBUTTAL TESTIMONY OF ENRIQUE A. LOPEZLIRA

Various parties, in addition to the Affected Utilities, have filed testimony endorsing the “net loss revenues” method of calculating stranded costs. For the following reasons, a net loss revenues approach is the poorest of the options available to the Commission for calculating stranded costs.

The net loss revenues method as proposed by the majority of the Affected Utilities (“utilities”) calculates stranded costs as the difference in the revenues received under competition, and the revenues utilities would receive if regulation were to continue. The net loss revenues method is an “administrative approach” for calculating stranded costs because the Arizona Corporation Commission’s staff (“Staff”) would be required to calculate the amount of stranded costs to be recovered. Thus, this approach would require staff to forecast what the utilities’ costs and the price and demand of electricity will be in a future competitive environment. Most advocates of the method propose that the affected utilities file estimates, which the Staff would then examine. A hearing would be required to ascertain the initial net loss in revenues for a period in time, and would require periodic true-up hearings necessary. The approach involves the Commission in continued regulation of a deregulated product market. Monitoring the effect of competition through some time in the future is not deregulation. Moreover, the method places an unnecessary burden on users, as cost of these laborious proceedings would be born by existing customers and taxpayers.

The most obvious problem with the net loss revenues method is that it requires predictions about future events made by individuals who have not operated in a competitive environment, and will not experience the direct economic consequence of their determination. Market value decisions are best made by market investors or buyers who better understand markets and evaluate risks. No matter how well thought out the administrative predictions will be, they are still likely to be inaccurate. Forecast errors will require periodic true-ups to replace old inaccurate estimates with new inaccurate estimates. Also, the time-consuming and contentious nature of these true-up proceedings makes them very costly.

Another problem with the net loss revenues approach is that it erroneously assumes that

1 because the competitive market price may be lower than the rate set under regulation, the
2 underlying assets are "uneconomic" in all markets, across all industries. The falsity of this
3 assumption is proven by recent sales of formerly regulated assets in other parts of the country, like
4 California and New England, where they were sold at prices way above book value. There is no
5 administrative methodology that can generate an order saying that a utilities assets under
6 competition are three or four times more valuable than their book value and, therefore, an
7 administrative evaluation is less likely to lead to zero stranded costs. Only a market can reflect
8 real-world enhanced values, and this has happened in other instances in other states applying a
9 market approach.

10 The stock market-value approach for calculating stranded costs would solve all the
11 problems with the net loss revenue approach. It is simple, because it does not get bogged down in
12 accounting rules and definitions. It is quick, because it saves on the time and money involved in
13 true-up hearings and other administrative proceedings. It provides a "net" measure of stranded
14 costs because it automatically offsets undervalued assets, such as the value of opening up new
15 generation markets to other affected utilities, against overvalued stranded assets. It is
16 economically efficient, because its speed and simplicity reduce the uncertainty for consumers,
17 competitors and investors. And, it is fair both to shareholders because it compensates them
18 directly, and residential users because it saves them from being burdened by paying for only truly
19 uneconomic assets, if any.

20 The net loss revenues approach is merely a mechanism for arriving at a market value of
21 those assets which are made uneconomic, not by management error, but by the shift to
22 competition. It is a poor substitute for a true market measure, which can be achieved more quickly
23 and with greater certainty and enhanced benefit to all classes of users.

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